

Dependent Care Proposed Regulations Redefined!

On May 24, 2006, the IRS released new proposed regulations under Code Section 21 regarding dependent care expenses, replacing regulations that were issued 22 years ago. These proposed regulations incorporate statutory changes that were made since the old regulations were issued and add new rules to address administrative concerns. There is no material change in the way ASI has already been handling these expenses. In general, the new regulations solidified the application of our interpretations.

Basic clarifications are as follows:

Kindergarten, Day Camp & Transportation To or From Care

The proposed regulations indicate that expenses of programs below kindergarten (e.g., preschool) may be employment-related expenses (and thus may qualify for the dependent care tax credit (DCTC) or dependent care flexible spending account (DCFSA), even though education may be a significant part of these programs. In contrast, kindergarten expenses are primarily educational and do not qualify as employment-related expenses, although before- and after-school care for children in kindergarten (and higher grades) may qualify.

In addition, the cost of a day camp may be a qualifying expense, even though the camp specializes in a particular activity, such as soccer or computers. (ASI has been accepting activity-specific day camps, with the exception of summer school charges. It is still ASI's opinion that summer school would be considered education and would not qualify for the DCFSA.)

The cost of transportation furnished by a dependent care provider to or from a place where care is provided may also be a qualifying expense. (ASI has not previously approved separately billed charges for transportation. Transportation by the care provider will now be accepted, even if itemized as a separate charge.)

“Indirect” Expenses

The proposed regulations clarify that expenses that relate to, but are not directly for, the care of a qualifying individual (e.g., application fees, agency fees, and deposits) may be employment related if the expenses must be paid in order to obtain the care. However, such expenses will not be for the care of a qualifying individual if care isn't ultimately provided (e.g., if a deposit reserving a place at a preschool is forfeited because the child ends up going to a different preschool). The examples provided in the proposed regulations support that the fee applies to the year in which the care provider actually provides the care. (ASI has consistently applied the application fees to the first day of care provided, after that care has been provided.)

Temporary Absences From Work

A taxpayer who is gainfully employed and who pays for dependent care expenses on a weekly, monthly, or annual basis is not required to allocate expenses during short,

temporary absences from work, such as for vacation or minor illness. Whether an absence is a short, temporary absence is determined based on all the facts and circumstances. The examples in the regulations support that a short absence of 1 or 2 days for vacation does constitute a temporary absence but an absence from work for a 4-month illness does not. (ASI has not been privy to temporary absence data and has not, and will not, deduct charges for care during temporary absences. However, ASI generally is aware of non-temporary absences due to missed payroll deductions for the DCFS and does investigate these “discrepancies” with the appropriate client personnel.)

Part-Time Work

A taxpayer who is employed part-time generally must allocate expenses for dependent care between days worked and days not worked. However, if a taxpayer employed part time is required to pay for dependent care on a periodic basis (such as weekly or monthly) that includes both days worked and days not worked, the taxpayer is not required to allocate the expenses. A day on which the taxpayer works at least 1 hour is a day of work. (ASI has and will continue to treat charges that are necessary to “hold the spot” at day care for part-time work as a qualifying expense unless information is submitted to indicate a discount or credit for days the child is not in care.)

Non-spousal parent

Payments made to the parent of the participant’s child even if the other parent is not the participant’s spouse do not qualify.

Effective Date

Even though the regulations are only proposed at this time, taxpayers may rely on these regulations now. Eligible dependent care expenses are defined in ASI prepared documents as employment-related expenses under Code Section 21.

For a complete copy of the Proposed Treasury Regulation Section 21, go to <http://edocket.access.gpo.gov/2006/pdf/E6-7390.pdf>

Please Note; ASI is sending this notice out via email to the contact addresses we have on file. If you do not receive this notice via email and you would like to sign up for future correspondence, please contact Pam Mallory at pam@asiflex.com so we can update our database. Thank you!